JOHN P. DAVIS, CLERK

No. 259

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

HOLIDAY LODGE, INC.,
Petitioner,

vs.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Respondent.

PETITIONER'S REPLY TO RESPONDENT'S OPPOSITION BRIEF.

MORRIS S. BROMBERG
SAMUEL E. HIRSCH
134 North LaSalle Street
Chicago 2, Illinois
Attorneys for Petitioner

CARROLL A. TELLER
1 North LaSalle Street
Chicago 2, Illinois
Of Counsel

The Scheffer Press, Inc.—ANdover 3-6850

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962.

No. 259

HOLIDAY LODGE, INC.,

Petitioner,

vs.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,

Respondent.

PETITIONER'S REPLY TO RESPONDENT'S OPPOSITION BRIEF.

---

1. Jurisdiction of this Court is invoked under Section 1254 (1) of Title 28 of the United States Code and not under Section 1251 (1) as erroneously set forth in our original petition because of a typographical error.

2. Under Section 714 of Chapter XI of the Bankruptcy Act Congress has provided that:

> "The Court . . . may, upon notice And for good cause shown, enjoin or *stay* until final decree any act or the commencement or continuation of *any proceeding to enforce any lien* upon the *property* of the debtor." (Italics supplied)

3. The majority opinion of the 7th Circuit Court of Appeals, in its decision here sought to be reviewed, held:

> ". . . the first mortgage here constitutes a lien on the property in question superior to the debtor's leasehold and to the extent of that lien, the *debtor* had *no interest in the real estate.*" • • • "Thus, both literally, according to the language of § 714, and as a matter of equity, the *court* did *not* have *jurisdiction under* this *section* to grant or continue the restraining order." (Italics supplied)

4. The separate opinion of Justice Duffy, dissenting on this point, states the law, in our opinion, correctly:

> "I do not agree with the statement in the opinion that the District Court did not have jurisdiction to *grant* or continue the restraining order, if that means that the District Court has *no* jurisdiction to restrain even temporarily a foreclosure when proceedings under Chapter XI have been instituted."
>
> • • •
>
> ". . . it now appears to be clear . . . that the court has power in a Chapter XI proceedings to exercise its injunctive and stay powers . . . against destructive or unduly damaging suits and foreclosures, at least temporarily and for good cause shown.
>
> "The fact that Chapter XI proceedings cannot affect the security of the first mortgage lien does not preclude the Bankruptcy Court from considering a plan and to restrain a threatened foreclosure while the Court may give consideration to that plan."

5. Consequently there is herein involved a question of important public law namely: Whether a debtor who has spent in excess of $1,000,000 erecting a building on a mortgaged fee, on which he owns a long-term leasehold, is entitled to the remedial benefits of a Chapter XI proceedings, so that the mortgagee may be temporarily

enjoined from foreclosing during the pendency of a petition and plan for arrangement, particularly where the foreclosure proceedings threatens to wipe out not only the fee but the leasehold as well?

The 7th Circuit Court of Appeals' ruling that a debtor's leasehold interest represented "no interest in the real estate" is in direct conflict with the decision of this Court in *Erie Railroad* v. *Tompkins*, 304 U.S. 64, that on the question of substantive law, the Federal Courts are bound by the law of the *situs*.

The Illinois Supreme Court in *Pierce* v. *Pierce*, 4 Ill. 2d 497, affirming 351 Ill. A. 336, 342, held on the question, as to whether a leasehold may be the subject of partition, that a long term leasehold interest was not only an interest in real estate but is equivalent to *actual ownership*, stating:

> "A 'lease is a conveyance of an estate in real property (citing cases). The possession of the tenant is in law the possession of the landlord. (citing cases) The *title* to a *leasehold* estate which lessee has during the life of a lease is equivalent for all practical purposes to *actual* ownership' (citing cases)." (Italics supplied)

6. Even putting aside for a moment the undisputable fact that under Illinois law a long term leasehold is not only an "interest in real estate" but is "equivalent . . . to actual ownership" and that the Federal Courts are bound by the law of the *situs*, the effect of the decision of the Court below is to hold that it was the Congressional intent, that where a debtor has a 25 year leasehold on real estate, which is subject to a mortgage lien, he is to be deprived of the statutory benefits of a Chapter XI proceedings otherwise conferred by Congress on a debtor who owns an outright fee.

From an economic standpoint, is there any substantial difference between a long term leasehold and a fee, when measured by the remedial benefits Congress clearly intended to grant to distressed debtors?

Is a debtor owning a leasehold, who invests $1,000,000 to erect a building on a fee, subject to a mortgage, any different from a debtor who owns a fee subject to a mortgage? The economics and humane reasons which motivate all legislation providing for reorganization or arrangement proceedings for necessitous debtors, surely has equal applicability to both.

If the lower court's construction of the Congressional intent is to prevail, a large class of debtors will be unjustly and arbitrarily discriminated against and deprived, without logic or reason, of the protection Congress intended to afford under Chapter XI when it granted to bankruptcy courts its stay powers under Sec. 714.

On the economic level, this Court will take judicial notice that throughout the country each year, increasingly, countless millions of dollars are being invested in the construction of buildings on leasehold property and that, as in the case at bar, this new construction is being financed by mortgage money. Indeed, these sale and leaseback arrangements are proving so popular for sound economic reasons that in many instances, the new construction, upon which the healthy economy of our nation depends, would be seriously affected if the lower court's construction of Chapter XI that a leasehold is "*not* an interest in the real estate" were to remain unchallenged.

In its opinion the lower court held that since debtor:

> ". . . took its lease subject to that mortgage lien . . . the bankruptcy court had no jurisdiction to restrain the . . . *lien* on the *property* to the extent that it was *superior to any interest* belonging to the *debtor* in that property." (Appendix p. 6a)

Carried to its logical conclusion this language would nullify *all* remedial relief not only for one owning a long term leasehold but for the owner of a fee as well, because even an outright fee on mortgaged property is *subject* to the superior lien of a mortgage. Thus, if the *superiority* of a mortgage lien over on interest in real estate, be it leasehold or fee, is held to be the absolute criterion, bankruptcy courts would automatically be deprived of the power to enjoin, even temporarily, the enforcement of a mortgage which is a lien superior to the interest of a debtor.

It must be obvious, therefore, that the lower court erred in holding as a matter of law that a debtor owning and in possession of a long term leasehold does not have the required property interest, referred to in Sec. 714 of Chapter XI, so as to entitle it to remedial relief.

II.

1. Having determined, however erroneously, that the District Court had no jurisdiction and power to enjoin the threatened foreclosure, even temporarily, the Court of Appeals might have stopped right there. Instead it went on to state by way of dicta that the continuance of the injunction and the District Court's refusal to vacate the same after it had been in effect for six months "shows an abuse of that court's discretion." A careful reading of the opinion makes it quite obvious that the Circuit Court of Appeals concluded that the District Court abused its discretion by not requiring the debtor to submit and proceed with a plan of arrangement.

This conclusion is unwarranted for the record clearly discloses that a plan of arrangement *was* submitted by the debtor. Furthermore, during that "six months" period the Referee and then the Judge were so preoccupied with respondent's repeated challenges to its jurisdiction, that it could not intelligently consider any plan.

Surely, it would have been legally economically unrealistic to proceed with an involved and expensive proceeding to bring an arrangement to a final decree where the basic question of jurisdiction over the mortgagee, so vigorously contested, was not yet finally determined.

2. While the importance of speed and dispatch in arrangement proceedings cannot be negated, here the delay in effectuating any plan of arrangements, was occasioned by *respondent's* vehement objections to the Court's jurisdiction. After six months of contesting the right and power of the court, to proceed and exercise jurisdiction, Respondents now turn about and charge the District Court with an abuse of discretion for not requiring debtor to submit a plan.

No court is warranted in proceeding with a debtor's plan of arrangement until all questions of jurisdiction have been resolved. Respondent set up a road block by raising the question of jurisdiction and now attempts to shift the responsibility for the delay they themselves caused.

That this is the correct view is demonstrated by the holding of this Court in *Continental Illinois Bank* v. *Rock Island Railroad*, 294 U.S. 648, 684, 685, referred to in our petition at pages 13 and 14.

In *Continental* the petitioners, holders of collateral of the debtor, had been enjoined by the District Court for a period of 1½ years from enforcing their claims; petitioner contended (as Respondent here contended) that the collateral would decline in value during any further period of restraint. Answering this contention the Court held that while the District Judge could not disregard the claim of injurious consequences, this was a matter ad-

dressed "not to the power of the Court but its discretion a matter *not subject to interference of an appellate court unless such discretion is improvidently exercised.*" (Italics supplied)

As shown in our petition on page 14, the Court further held:

> "But the delay is due to the many doubts and uncertainties arising from the present litigation. Until they are finally resolved, the consummation or preparation of any definite plan is plainly impractical."

3. Under the authority of *Continental*, while debtor was not obliged to submit a plan, nevertheless as shown in our petition at page 7, (Respondent's A. 40, 79, 95, 96) the record makes it manifestly clear that, in the instant case, debtor did attempt to submit a plan within the six month period.

What was said by this court in *Continental* was reiterated subsequently in *Equitable Office Building Corporation*, 92 L.ed. 1387, 1390, as shown in our petition at p. 14, where Justice Reed ruled in a Chapter X case:

> "Delay in reorganization due to uncertainty of legal rights is regrettable but inevitable in such a situation as this."

4. While expeditious handling of reorganization procedures under the Chandler Act is essential, it is now clear that Congress did not intend to provide that realistic consideration of practicability be sacrificed on the altar of speed. In 1958, Congress amended Sec. 323 (28 U.S.C.A. § 723) by eliminating the mandatory requirement that a plan of arrangement accompany the petition for arrangement.

Sec. 323 was amended by Public Law 85-732, 85th Congress, 2nd Sess., approved August 24, 1958. In Senate Report No. 2094, the purpose of that amendment is explained as follows:

> "The language of section 323 of Chapter XI now makes it mandatory that a plan of arrangement be filed with the petition. The proposed legislation would make this permissive rather than mandatory and thus permit a plan of arrangement to be filed subsequently . . .
>
> "In its favorable report on the proposed legislation, the committee on the Judiciary of the House of Representatives has commented as follows on the desirability of this change:
>
> The present requirement that the plan of arrangement be filed along with the Chapter XI petition has been found to be unrealistic and has resulted in either pro forma compliance by the filing of a hastily dratfed plan, or the adoption by some judges of extra-legal practices permitting filing of the petition without an accompany (*sic*) plan. It takes time and careful study to work out a realistic appropriate plan for a debtor. When a petition must be filed speedily to hold off marshalls or sheriffs, pro forma compliance with the requirement is the inevitable result, and the proceedings are then often encumbered with a poorly drafted, unworkable, or inequitable plan. (This legislation) adopts a more flexible procedure by permitting the filing of a petition alone, allowing time for the careful drafting of an effective and fair plan of arrangements which can be filed later." (See Collier; Bankruptcy Act. Pamphlet Ed. 1960)

From this it follows that Congress intended that this provision (Sec. 323) be liberally construed, and that the Court be allowed great latitude.

CONCLUSION.

We most earnestly urge that this Court consider that the case at bar involves a legal question of great public interest, undetermined by this Court, which affects the vital rights of the holders of millions of dollars of leasehold property throughout the United States, namely, whether Section 714 of Chapter XI of the Bankruptcy Act can properly be construed to exclude from the scope of its protection, the holders of leasehold property, particularly where there is no apparent legal or economic reason to attribute to Congress any such intent or construction.

Another question of vital significance concerns the administration of the Bankruptcy Act as it applies to the Chandler Amendment, namely, whether a District Court abuses its discretion in not requiring a plan of reorganization to be filed and acted upon while a fundamental challenge to its power is still pending.

In the case at bar, the leasehold of the debtor, which has an undisputed value of $1,250,000 (Respondent's appendix p. 94) or approximately $450,000 over and above the mortgage indebtedness, (Respondent's appendix p. 93) provides the first lienholder with more than an ample cushion of security.

For the Court of Appeals to hold that such a valuable long term leasehold is not property within the purview of Sec. 714 so as to confer jurisdiction upon a Bankruptcy Court in a Chapter XI proceedings to temporarily enjoin a foreclosure by a mortgagee which would wipe out that leasehold, does violence to the spirit and intent of the remedial legislation which is clearly designed to rehabilitate and not liquidate the debtor.

Unless the relief prayed for in this petition is granted, not only will there be unjust enrichment to the mortgagee and total destruction of the leasehold, fee rights and the rights of unsecured creditors but the economic consequences to leasehold transactions throughout the nation will be incalculable and will result in confusion in the administration of the Bankruptcy Act.

Respectfully submitted,

MORRIS S. BROMBERG
SAMUEL E. HIRSCH
Attorneys for Petitioner.

CARROL A. TELLER
Of Counsel.